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Non-competition clauses in labour contracts

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Preliminary remarks

In this questionnaire, "plaintiff" refers to the employer with whom the employee signs the labour contract. "Defendant" refers to the employee who signed the labour contract. Sometimes the new employer can also be a defendant.

The law governing covenants not to compete in labour contracts relates to many areas of the law (such as freedom of occupation, freedom of contracts, etc.) and may be taken into consideration when replying to the questionnaire. This subject also relates to theories of economics and freedom of trade and competition, which can also be taken into account.

1. What clauses, if any, are in your country's constitution relating to covenants not to compete in labour contracts? Are there clauses relating to the freedom of occupation; protection of property (if so, does this include intellectual property and trade secrets); freedom of contract, etc. If there are such clauses, how are they applied relating to covenants not to compete? Which, if any, of the EU Directives relating to this subject are applied in your country?

   The Constitution has some relevant articles:

   9 Article (2) The Republic of Hungary recognizes and supports the right to enterprise and the freedom of economic competition. **Right to enterprise, freedom of economic competition, fair market practices,**

   13 Article (1) The Republic of Hungary shall guarantee the right to property. **Fair market practices, protection of business/trade secrets**

   59 Article (1) In the Republic of Hungary everyone has the right to the good standing of his/her reputation, the inviolability of his/her private home and the protection of his/her personal secrets and data. **These are the rights of the enterprises as well: not only the business secrets are protected, but other data which are connected with reputation. On the other hand the covenant not to compete could reduce this right of employee: after the termination the employee has to inform the former employer about his/her new employment, profession, etc.**

61 Article (1) In the Republic of Hungary everyone has the right to freedom of expression, and to receive and import information of public interest. **The covenant not to compete could reduce the right of freedom of expression of employee.**

70/B Article (1) In the Republic of Hungary everyone has the right to work and to choose freely his job and profession. **The covenant not to compete could reduce this right of employee: employment with some kind of employer or employment in some kind of profession could be excluded during a future period.**

In the practice there is very rare to bring a lawsuit which is based directly on the provisions of the Constitution of the Republic of Hungary (Act XX of 1949, hereinafter Constitution). The constitution is relevant at the interpretation and foundation of other statues. It is the competence of the Constitutional Court, but nowadays more often the parties refer to these provisions besides the directly applicable legal provisions.

There is no EU directive what would directly deal with covenants not to compete. Freedom of economic competition and its possible limits are determined and regulated by the EC Treaties and other orders.

2. Is there a statute in your country that governs the enforceability of covenants not to compete? Or, is the law governed solely by case law?

There is no specific statue, act or order what would regulate exclusively the covenants not to compete. There are several statues contain regulation to the covenants not to compete, although they don't use this expression. These statues are the following: Labour Code, Civil Code, and the Act of prohibition of unfair market practices and restriction of economic competition.

The Labour Code regulates the covenants not to compete in the following way:

Article 3 (5) While under employment relationship, employees shall not engage in any conduct by which to jeopardize the rightful economic interests of the employer, unless so authorized by a legal regulation.

Employees shall remain subject to the obligation set forth in Article (5) above following termination of the employment relationship only on the basis of an agreement concluded for such purpose in exchange for appropriate consideration, and for no more than a period of three years. The provisions of civil law shall apply to such agreements.

From the above mentioned provision it is clear that covenants not to compete can be concluded **just for the period following the termination of the employment relationship.**

During the employment-relationship the following provisions are valid:

Article 103 (3) Employees shall not disclose any industrial (business) secrets obtained in the course of work, nor any information of fundamental importance pertaining to the employer or its activities. Furthermore, employees shall not convey any data learned in connection with the fulfillment of their position to unauthorized persons, the revealing of which would result in detrimental consequences for the employer or other persons.

Article 191 (2) a) Executive officers shall not acquire shares, with the exception of the acquisition of stocks in a public company limited by shares, in a business association which

is engaged in the same or similar activities or is in regular business contact with their employer.

The provisions of civil law shall apply to covenants not to compete. This type of contract is not listed in the Civil Code. It is close to the contract for work regarding their content. The employee takes upon himself that for a fix period he is stopping to do something. The covenants not to compete should be judged according to the general rules of the contract (breach of contract, form of contract, invalidity, obligation to cooperate).

The courts' practice has a significant role in determining the following questions: what can be the subject of service, appropriate consideration, when can give a notice to quit.

If there is a statute, does the statute relate to specific professions or industries?

See above.

3. In general, are covenants not to compete in labour contracts enforceable in your country? Following are some possible answers:

(a) In my country covenants not to compete are not enforceable under any circumstances.

If they are not enforceable, explain the legal and economic basis for this rule.

(b) In my country covenants not to compete are enforceable under certain conditions and to a certain extent.

These are enforceable

(If the answer is yes, there are further questions about the condition required for the covenant to be enforceable.)

The Labour Code determines three conditions:

- the service of the employee should be such a conduct, what protects the rightful economic interests of the employer,
- there is a three year time limitation,
- the employer should give an appropriate consideration for the service.

In other aspect the general rules of Civil Code are valid and effective (invalidity, disproportionality).

4. What are the employer's protected interests and how are they defined?

What is the public's interest in enforcing covenants not to compete? Is this a reason for statutes and case law?

There is no statutory definition for the concept of "rightful economic interests of the employer". However from the relevant provisions the protected interests can be indirectly determined (for example clients' list, know-how, trade secret).

The covenants not to compete can guarantee the balance of the competing rights. These rights are the following: right to work, right to enterprise, freedom of economic competition, freedom of expression, protection of property, protection of data.

5. If covenants not to compete are enforceable in your country: what must the plaintiff show to prove the existence of an enforceable covenant not to compete?

(a) Is a written contract required?

According to the Act the writing form is not necessary, although in practice covenant not to compete is the part of the employment contract, which should be concluded in writing.

(b) Is a trade secret required to prove the employer's case? If so, how is a trade secret defined? Does it include customer lists, price lists, systems of work?

Typically the trade secret, as a condition is not examined. The reason for this that the trade secrets couldn't be subject of the covenant not to compete, because an independent act (Act of prohibition of unfair market practices and restriction of economic competition) regulates that the employee should protect and not disclose the trade secrets after the termination of the employment relationship. If the employee in the covenant not to compete takes upon himself to protect the trade secrets, it would mean stopping from an unlawful activity. It would be similar to a contract in which somebody shoulder to not murder the other contracting party.

There can be some kind of indirect significance to the question, that the know-how/practice which the employee studied in the previous employer is utilizable at the new employer or not. So did the employee breach the contract or contrary to this he accomplished it an appropriate way.

(c) Does the employer need to give the employee consideration (in addition to a regular salary) as a condition for the covenant not to compete to be enforceable?

Yes

(d) Will geographical factors, time factors and the special characteristics of an industry be considered when deciding whether to enforce a covenant not to compete?

See above 3 b)

The Labour Code mentions only the time limit, which is maximum three years. The other circumstances are the part of the contractual freedom. It is especially important that these circumstances (for example which firm he could not make employment contract with, where he can not be employed) should be determined unambiguously in the contract.

(e) Must the covenant not to compete meet a "reasonable test"? If so, who has the burden of proof? How, if at all, does your case law balance between such rights as freedom of contract, property rights and freedom of occupation?

Yes, in the covenants not to compete the service and the counter-service should be in balance. This appropriateness in a lawsuit can be determined after the examination of all the circumstances. For example: we should examine that what kind of chance had the employee to find a job regarding his qualification, diplomas, and professional experiences. What damage he suffered because of the limitation, and whether this is appropriately compensated by the money he got from the employer or not.

The burden of proof determined by the general provisions of the Code of Civil Procedure: Facts required for the adjudging of a case must be proved by the party who is interested in their acceptance are real by the court.

How does the case law balance between the rights? The answer is difficult, because we have comparatively few cases, and the lawsuits are different. We could not say for example

that the right of freedom of contract is stronger than the protection of property etc. The court shall evaluate proofs as a whole and adjudicate the case according to its conviction, and decides according to the law.

(f) May the new employer be sued for employing an employee who is violating the covenant not to compete in his labour contract with the former employer? If so, in which court? Is this hearing held jointly with the suit against the employee? Note: the new employer has no contract with the former employer and there is no employee-employer relation between them.

The rights and obligations of the covenants not to compete are only binding for the contractual parties: employer and employee. It does/should not contain provision for an unknown third party, the new employer. The new employer are responsibly for the damaged that he/she cause to the old employer for example with getting the customers' list by fraud according to the rules of the Civil Code and the Act of prohibition of unfair market practices and restriction of economic competition. This kind of lawsuit falls within the competence of the civil law and not the labour/employment law courts. If there wasn't a covenant not to compete, the employee's responsibility also exists according to these rules and not the Labour Code. The damaged former employer shall be entitled:

- to demand compensation, or
- to demand for such former employee to relinquish to the employer the agreement concluded for himself in lieu of compensation, or
- to demand that such former employee surrender his profit originating from a deal concluded on another's behalf or to transfer his claim thereto to the employer.

There is a possibility to order liquidated damages according to the rules of the Civil Code in the covenant not to compete in case of contractual breach of the employee. Both the dispute regarding liquidated damages and a complaint based on the covenant not to compete fall within the competence of the Labour Court. In front of the Labour Court only the employee and the ex-employer can be a party. The new employer only intervening party can be.

(g) If the employer terminates the labour contract, is the covenant not to compete enforceable? Does it matter what the reason for the dismissal is?

Yes, furthermore the covenant not to compete can be concluded especially in the case of termination, for the following period of termination. The parties can agree in the covenant that there is an importance of the method of the termination.

7. If a covenant not to compete is held by a court in your country to be overly broad, will the court modify the covenant? What other flexibility do courts have relating to relief they can grant?

The Civil Code gives the right to the court to modify the parties' long-term agreement if after the signing of the contract the circumstances change and this change hurts one party's important, lawful interests. In the practice we almost never use this rule. In most cases the subject of the lawsuit is the breach of the contract or the invalidity of the contract. The court's decision just follows the plaintiff's expressed request.

8. Do the courts issue preliminary (temporary) injunctions for violation of covenants not to compete in labour contracts?

   The Code of Civil Procedure contains provisions about the temporary order. Its says that if the defendant's liability for performance seems probable according to the data of an action brought for alimony, allowance or another similar temporary provision, the defendant may be bound by a temporary order at the plaintiff's request or in the line of duties - if necessary - to pay the presumably awardable alimony (allowance) or to perform another service due from the date of submitting the request. In the practice it is quite rare. We do not have information about wasit used in a lawsuit connected covenant not to compete.

9. What are the remedies which courts can and do grant when an employee has violated his/her covenant not to compete?

   In the case of violation of the covenant not to compete the remedies follow the provisions of the contract (for example liquidated damages) or the party can request the remedies regulated in the Civil Code (compensation, rescind the contract). This lawsuit fall the competence of the Labour Court. The employer can request other issues also together with the remedies of the violation the covenant not to compete. This lawsuit also fell in the competence of the Labour Court.

10. Which court(s) in your country have jurisdiction over legal matters relating to covenants not to compete in labour contracts? (Labour Courts; Civil or Commercial Courts; Administrative Law Courts; Constitutional Court, etc.).

    Labour Court. (See above 5f) and 9)

11. Are there any leading or illustrative judgments that you would like to describe relating to covenants not to compete in labour contracts?

    If the covenant not to compete regulates the right to rescind the contract, it can be used by the employer just before the employee's accomplishment. In the certain case the employee took upon himself that after the termination of the employment relationship, he won't work in businesses having special activities. The employer took upon himself that for this he will pay 6 month wages. The parties terminated the employment relationship with mutual agreement. After the employee asked for the 6 months' wages, then the employer rescinded the contract. The labour court judged the 6 months' wages, because the right to rescind can be practised only before the beginning of accomplishment, before the termination of the employment contract.

    The employer suited the employee for 1 million HUF in a lawsuit, because he stated that the employee violated the covenant not to compete. In the contract the employee took upon himself that for one year after the termination of the employment relationship he reports the employer every new employer where he would like to work with the employer's precise name. Then the ex-employer can prohibit the employment contract and he pays 20 percent of the annual wage. The contract contained that if the employee violated the contract he has to pay 1 million HUF. After the termination the employee reported that he doesn't make an employment relationship which would violate the contract. However he denied reporting his new employer's data. The court considered that there wasn't appropriate compensation for the obligation of the report; there wasn't an appropriate

equivalent for the case if he prohibits the relationship. So this part of the contract is null because the appropriate consideration. So the employee didn't violate the contract.

Do you have any additional remarks on this subject?